

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF MULBERRY)	
ENTERPRISES, INC. FOR AN)	
ADJUSTMENT OF RATES PURSUANT)	CASE NO. 95-515
TO THE ALTERNATIVE RATE FILING)	
PROCEDURE FOR SMALL UTILITIES)	

O R D E R

On November 14, 1995, Mulberry Enterprises, Inc. ("Mulberry") filed its application for Commission approval of proposed sewer rates. Commission Staff, having performed a limited financial review of Mulberry's operations, has prepared the attached Staff Report containing Staff's findings and recommendations regarding the proposed rates. All parties should review the report carefully and provide any written comments or requests for a hearing or informal conference no later than 15 days from the date of this Order.

IT IS THEREFORE ORDERED that all parties shall have no more than 15 days from the date of this Order, or 90 days after the date the application was filed, whichever is later, to provide written comments regarding the attached Staff Report or requests for a hearing or informal conference. If no request for a hearing or informal conference is received, this case will be submitted to the Commission for a decision.

Done at Frankfort, Kentucky, this 12th day of February, 1996.

ATTEST:

PUBLIC SERVICE COMMISSION


Executive Director


For the Commission

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF MULBERRY ENTERPRISES,)
INC. FOR A RATE ADJUSTMENT PURSUANT TO)
THE ALTERNATIVE RATE FILING PROCEDURE) CASE NO. 95-515
FOR SMALL UTILITIES)

STAFF REPORT

Prepared By: Carl Salyer Combs
Public Utility Financial
Analyst, Senior
Water and Sewer Revenue
Requirements Branch
Financial Analysis Division

Prepared By: John Geoghegan
Public Utility Rate
Analyst
Communications, Water and
Sewer Rate Design Branch
Rates and Research Division

STAFF REPORT

ON

MULBERRY ENTERPRISES, INC.

CASE NO. 95-515

A. Preface

On November 14, 1995, Mulberry Enterprises, Inc. ("Mulberry") filed an application with the Commission seeking to increase its sewer rate pursuant to the Alternative Rate Filing Procedure for Small Utilities. The proposed rate would generate approximately \$18,557 annually in additional revenues, an increase of 54.7 percent over normalized test-year revenues of \$33,858.

In order to evaluate the requested increase, the Commission Staff ("Staff") chose to perform a limited financial review of Mulberry's operations for the test period, calendar year 1994. Since Mulberry requested and received Staff assistance in preparing this application, Staff's review was done prior to the filing of the application. Carl Salyer Combs of the Commission's Division of Financial Analysis is responsible for the preparation of this Staff Report except for the determination of Operating Revenue and Rate Design, which were prepared by John Geoghegan of the Commission's Division of Rates and Research.

During the course of the review, Mulberry was informed that all proposed adjustments to test-year expenses must be supported by some form of documentation, such as an invoice, or that all such adjustments must be known and measurable. Based upon the findings of this report, Staff recommends that Mulberry be authorized to

increase its annual operating revenue by \$18,505 over normalized revenues of \$33,858.

Scope

The scope of the review was limited to obtaining information to determine whether reported test-period operating revenue and expenses were representative of normal operations. Insignificant or immaterial discrepancies were not pursued and are not addressed herein.

B. Analysis of Operating Revenue and Expenses

Operating Revenue

Mulberry's 1994 annual report indicates that it had revenue from rates during the test year of \$33,397. A calculation of its revenue from rates for 1994 based on its year-end number of customers (198 customers x 12 months x \$14.25 per month) yields a normalized revenue figure of \$33,858, a difference of \$461 over test year reported revenue.

Operating Expenses

Mulberry reported test-period operating expenses of \$37,598 which it proposed to increase by \$7,381. Staff's recommendations and Mulberry's proposed adjustments are discussed in the following sections:

Management Fee

Mulberry reported no test-year management fee, but proposed an annual fee of \$3,600. The Commission's normal practice in cases involving small sewer utilities is to allow an annual management fee. The management duties of Mulberry's manager are comparable to

the general oversight responsibilities of a water district commissioner. According to KRS 74.020 (6), a water district commissioner shall receive annual compensation of not more than \$3,600. Staff is of the opinion that such an amount is appropriate in this instance and recommends inclusion of an annual management fee of \$3,600 for rate-making purposes.

Chemicals Expense

Mulberry reported no test-year chemicals expense. However, a review of invoices revealed that test-year purchases of chemicals totaling \$657 had been included in an account for miscellaneous supplies and expenses. Staff is of the opinion that expenditures for chemicals should be charged to the chemicals expense account, and therefore recommends that annual chemicals expense of \$657 be included for rate-making purposes.

Miscellaneous Supplies and Expenses

Mulberry reported test-year miscellaneous supplies and expenses of \$1,788. As mentioned previously in the section on chemicals expense, Staff recommends reclassification of test-year charges of \$657 for chemicals to the chemicals expense account.

Mulberry proposed an adjustment to this account to reflect increased testing fees. The adjustment is based upon more stringent requirements by the Kentucky Natural Resources and Environmental Protection Cabinet ("Natural Resources"). Mulberry provided a copy of a letter from Natural Resources which specifies the frequency of testing required for each of Mulberry's sewage treatment plants.

Since both the annual number of tests required by Natural Resources and the cost per test performed by McCoy & McCoy are known, Staff recommends inclusion of annual miscellaneous supplies and other expenses of \$3,499¹ for rate-making purposes.

Internal Supervision Expense

Mulberry reported test-year internal supervision expense of \$13,770 which represents wages paid to Paul Mulberry, the owner of the utility. In addition to managing the utility, Mr. Mulberry performs all of the maintenance duties, both routine and non-routine in nature. According to a maintenance log kept by Mr. Mulberry, he worked 1377 hours during 1994 and was compensated at the rate of \$10 per hour.

In support of test-year wages, Mulberry provided a written quote from Noel Norton, a licensed Class III operator, to provide maintenance services for Mulberry's three treatment plants. Mr. Norton currently operates Willowcrest Development Corporation's treatment plant and is also an operator for the City of Georgetown's wastewater treatment plant. Mr. Norton's annual charge to maintain Mulberry's plants would be \$21,000.

Staff is of the opinion that Mr. Mulberry's test-year compensation is reasonable and recommends inclusion of annual internal supervision expense of \$13,770 for rate-making purposes.

¹ Edgewood - weekly testing; \$51.45 x 52 weeks = \$2,675.40
Farmgate - monthly testing; \$51.45 x 12 months = 617.40
Meadowbrook - quarterly testing; \$51.45 x 4 quarters = 205.80
Total annual expense \$3,498.60

Office Supplies and Other Expenses

Mulberry reported test-year office supplies and other expenses of \$365. A review of invoices and canceled checks revealed a payment of \$386 (an amount close to the reported total of \$365) for various items. However, the check carried a 1993 date and, therefore, should not have been included with 1994 expenses.

A test-year payment of \$41 for postage and other such office supplies could properly have been charged to this account. Therefore, Staff recommends inclusion of annual office supplies and other expenses of \$41 for rate-making purposes.

Transportation Expense

Mulberry reported no test-year transportation expense, but provided statements from oil companies and canceled checks to document test-year gasoline purchases of \$1,846. According to Mulberry, the vehicle for which gasoline purchases were made was used 80 percent of the time for utility business. Thus, Staff recommends inclusion of annual transportation expense of \$1,477² for rate-making purposes.

Miscellaneous General Expense

Mulberry reported miscellaneous general expense of \$45. As mentioned previously in the section on office supplies and other expenses, a test-year payment of \$41 was made for postage, etc. It appears that \$45 was mistakenly reported rather than the correct amount of \$41. Furthermore, the \$41 charge has already been included for rate-making purposes in the aforementioned account.

² \$1,846 x .8 = \$1,477

Therefore, no annual miscellaneous general expense has been included for rate-making purposes.

Depreciation Expense

Mulberry reported test-year depreciation expense of \$1,639. According to Mulberry's accountant, Mr. Robert Bass, CPA, the allowable depreciation expense on non-contributed property for the test-year should have been \$108.

According to Mulberry, several items of equipment are required to bring the plants into compliance with Natural Resources standards. A letter from Natural Resources, cited previously in this report, informed Mulberry that a continuous flow monitoring device is required for the Edgewood treatment plant. Mulberry provided a copy of a cost estimate for the flow meter from Purestream, Inc. of Florence, Kentucky, which reflects a total cost (including installation) of \$5,409. According to the Commission's Engineering Division, the flow meter should be depreciated over ten years which results in annual depreciation expense of \$541.

The Commission's Engineering Division concurs with Mulberry's assertion that other items of equipment are needed. Mulberry provided copies of related cost estimates for the equipment. Those items, along with associated costs, estimated useful lives, and resulting annual depreciation expense are listed as follows:

<u>Equipment</u>	<u>Cost</u>	<u>Est. Life</u>	<u>Annual Dep. Exp.</u>
Comminutor	\$ 2,441	5 years	\$ 488
Electrical Enclosure	198	10 years	20
21' 6" channel, etc. for Farmgate plant	684	3 years	228
21' 6" channel, etc. for Edgewood plant	684	3 years	228

Altogether, Staff recommends annual depreciation expense of \$1,613³ be included for rate-making purposes.

Amortization Expense

Mulberry reported no test-year amortization expense, but has proposed recovery of the cost to have 50 loads of sludge hauled from the lagoon at the Edgewood treatment plant. The Commission's Engineering Division agrees that hauling 50 loads of sludge from the lagoon would be reasonable. In support of its proposal, Mulberry provided a copy of an estimate from Perry's Septic Tank Service of Frankfort, Kentucky, for \$5,000 (50 loads at \$100 per load). The Commission's Engineering Division is of the opinion that the cost of this undertaking should be amortized over 10 years. Therefore, Staff recommends inclusion of annual amortization expense of \$500 for rate-making purposes.

³ Allowable Test-Year Expense \$ 108

Add:

Ann. Dep. Exp. on Flow Meter	541
Ann. Dep. Exp. on Comminutor	488
Ann. Dep. Exp. on Electrical Enclosure	20
Ann. Dep. Exp. on Channel for Edgewood	228
Ann. Dep. Exp. on Channel for Farmgate	<u>228</u>
Total Annual Depreciation Exp.	<u>\$ 1,613</u>

Taxes Other Than Income Taxes

Mulberry reported taxes other than income taxes expense of \$1,659. Staff's review found support for test-year charges to this account of \$1,490 and recommends inclusion of annual taxes other than income taxes expense of \$1,490 for rate-making purposes.

Operations Summary

Based on the recommendations of Staff contained in this report, Mulberry's operating statement would appear as follows:

	<u>Test Period</u> <u>Application</u>	<u>Recommended</u> <u>Adjustments</u>	<u>Test Year</u> <u>Adjusted</u>
OPERATING REVENUE	\$ 33,397	\$ 461	\$ 33,858
OPERATING EXPENSES:			
Owner/Mgmt. Fee	\$ -0-	\$ 3,600	\$ 3,600
Sludge Hauling	900	-0-	900
Water Cost	610	-0-	610
Rent	2,700	-0-	2,700
Electricity	7,576	-0-	7,576
Chemicals	-0-	657	657
Misc. Supplies & Exp.	1,788	1,711	3,499
Internal Supervision	13,770	-0-	13,770
Maint. of Collection System	230	-0-	230
Agency Collection Fee	5,009	-0-	5,009
Office Supplies & Other	365	(324)	41
Outside Services	1,307	-0-	1,307
Transportation	-0-	1,477	1,477
Misc. General	45	(45)	-0-
Depreciation	1,639	(26)	1,613
Amortization	-0-	500	500
Taxes Other Than Income	1,659	(169)	1,490
Total Operating Exp.	<u>\$ 37,598</u>	<u>\$ 7,381</u>	<u>\$ 44,979</u>
OPERATING INCOME	\$ (4,201)	\$ (6,920)	\$ (11,121)
OTHER INCOME			
Interest & Dividend	<u>54</u>	<u>-0-</u>	<u>54</u>
NET INCOME	<u>\$ (4,147)</u>	<u>\$ (6,920)</u>	<u>\$ (11,067)</u>

C. Revenue Requirements Determination

The approach frequently used by the Commission to determine revenue requirements for small, privately-owned utilities is the calculation of an operating ratio.⁴

This approach is used primarily when there is no basis for a rate-of-return determination or due to the fact that the cost of the utility plant has been recovered fully, or largely, through the receipt of contributions, either in the form of grants or donated property. As Mulberry fits this description, Staff recommends use of an operating ratio for determining revenue requirements. The ratio generally used by the Commission in order to provide for equity growth is 88 percent. In this instance, use of an 88 percent after-tax operating ratio applied to the adjusted test-year operating expense results in a total revenue requirement of \$52,417

⁴ Operating ratio = operating expense/operating revenue

and increased revenues of \$18,505.⁵ Therefore, Staff recommends an increase of \$18,505 in annual revenues.

D. Rate Design

In its application, Mulberry filed a schedule of present and proposed rates. Staff is of the opinion that the present flat rate design is reasonable. Mulberry did not propose to change its present rate design, therefore, any change in revenue in this case will be added to or subtracted from the existing rate structure. The rate set out in Appendix A will produce \$52,417 annually.

⁵ Adjusted Operating Expense/Operating Ratio	\$44,979/.88
Required Operating Revenue Exclusive of Provision for Income Taxes	\$51,112
Required Operating Revenue without Tax Provision	\$51,112
Less: Adjusted Operating Expense	<u>(44,979)</u>
Net Operating Income Exclusive of Provision for Income Taxes	\$ 6,133
Net Operating Income Exclusive of Provision for Income Taxes/Complement of Composite Tax Rate	\$ 6,133/.8245
Net Operating Income Inclusive of Provision for Income Taxes	\$ 7,438
Adjusted Operating Expense	\$44,979
Add: Net Operating Income with Income Tax Provision	<u>7,438</u>
Revenue Requirement Inclusive of Income Tax Provision	<u>\$52,417</u>
Revenue Requirement	\$52,417
Less: Adjusted Test-Year Operating Revenues	(33,858)
Less: Other Income	<u>(54)</u>
Amount of Increase Required	<u>\$18,505</u>

E. Signatures

Carl Salyer Combs

Prepared By: Carl Salyer Combs
Public Utility Financial
Analyst, Senior
Water and Sewer Revenue
Requirements Branch
Financial Analysis Division

John Geoghegan

Prepared By: John Geoghegan
Public Utility Rate Analyst
Communications, Water and
Sewer Rate Design Branch
Rates and Research Division

APPENDIX A
STAFF REPORT CASE NO. 95-515
MULBERRY ENTERPRISES, INC.

The following rate is recommended for customers of Mulberry Enterprises, Inc.

Monthly Rate:

\$ 22.10